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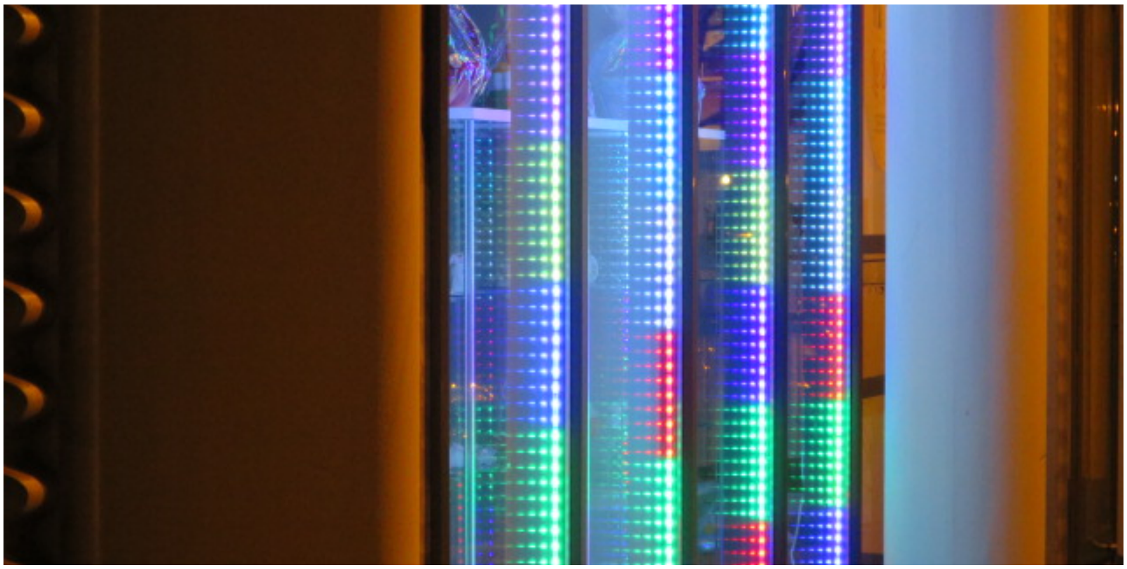

TONY NORFIELD 2017-09-07

FACEBOOK'S ADVERTISING MACHINE

ECONOFICTION CAPITAL, FACEBOOK, FINANCE, MARXISM, PLATTFORM CAPITALISM

When Mark Zuckerberg is interviewed, the founder of Facebook can barely put a sentence together without using the word 'connect'. This looks like a case of Tourette's syndrome that spouts business buzz words not curses. But it is based on his understanding of the source of his company's revenues and almost all of these come from advertisers. They pay to put their offerings to Facebook's two billion users, since it claims to know about these people and what they like. This is Facebook's business model: to monetise connections to its platform.

In this way, Facebook has made it into the top 10 of corporations on global stock markets. Its business throws light on the way the imperialist economy works.

THE ADVERTISING GAME

It is not much good making a product or service for sale if people do not know about it and buy it. Hence, advertising. From TV commercials and sponsorships, to pages in newspapers, to the ubiquitous logos on sportspeople, on billboards, on the clothing people buy and on images online, this is no small business. Global advertising expenditure in 2016 was estimated at $493bn.[1] A huge sum of money is available for the right destination.

Advertising is key feature of the capitalist market, especially when that market is global and not just down the road. Major corporations use advertising to put their brands in the public eye and fight for their market share. Spending millions or billions on advertising is a necessary part of becoming, and staying, a monopolist, since economic power is about market domination.[2]

But the right destination for advertising spending can still be difficult to determine. In general, the bigger the audience for advertisers, the better, although it still might be the wrong audience for what is being sold. As the business cliché puts it: 'half of our spending on advertising is useless, but we don't know which half'. This is where the growth of online media has become more important in the past decade or so: it can claim to provide a better answer to that question.

Television, with the largest audience coverage, still dominates 'offline' sales of adverts, totalling $186bn in 2016. A long way behind television advertising revenues are those for print media and radio. Offline advertising also accounts for the bulk of total

revenues, with last year's share estimated at 64%, or $315bn. But offline advertising growth has been stagnant in recent years, and is being rapidly caught up by the newer digital media.

From a small starting point, spending on digital media has been growing quickly. Digital advertising now accounts for 36% of the total spending, at $178bn, and its share will grow further, especially on mobiles and especially via search, such as Google, and on social applications, such as Facebook.

The economics of those media companies relying on the offline advertising market is being slowly undermined by digital communications, especially in the case of newspapers. In the digital advertising world, Google and Facebook are the dominant forces, together having more than half the digital advertising revenues. Google has a much bigger share than Facebook, and also has a stock market capitalisation of around $650bn compared to Facebook's at just below $500bn, helped by the fact that its system accounts for 90% of all Internet searches. But Facebook is a sizeable member of this giant duopoly.[3]

Facebook has two big advantages over offline media. It can just provide a platform, and rely upon other people to produce the content that is shared on its system, rather than having to produce that content itself. It also has a more detailed view of the profile, likes and inclinations of its users than is possible for television companies or newspapers. This is the core value it offers to potential advertisers: not just a big and growing audience, but one differentiated by age, gender, location and likes.

THE BIG CONNECTOR

Facebook differs in a number of respects from the other major corporations covered on this blog in recent months – Apple, Alibaba and Amazon. It has far less investment in financial securities and derivatives than Apple, and I will not cover these aspects here.[4] It also has a more geographically diverse client base than either Alibaba or Amazon. However, one feature of its business that is critical, as for Apple and Amazon, is that it was founded in the large and rich US market.

In mid-2017, Facebook's average revenue per user in the US and Canada was $19.38, nine times that for Asia, which was just $2.13. But Facebook's audience in Asia is growing fastest, and accounted for 34% of the average daily number of users by mid-2017, compared to 14% for the US and Canada and 20% for Europe.

The US market evidently has a powerful influence on social trends elsewhere in the world. It has been shown not only by the popularity among youth of wearing low-hanging trousers and baseball caps backwards – although, thankfully, these trends have, like, faded – but also by how a system designed for an elite US university, Harvard, could end up becoming the world's largest social media site. The Bullingdon boys of Oxford University in the UK have not come anywhere close to this, although they have distinguished themselves on a much smaller scale by providing politicians who help fill the UK news media.

With 97% or so of Facebook's revenues derived from advertising, and with the bulk of those advertising contracts being subject to cancellation *within one month*, one would think that financial markets would look upon this business model as very shaky indeed. That impression would be endorsed by the fact that Facebook has not paid any dividends on its shares since these were issued to investors in 2012. But the share price has nevertheless risen dramatically and an early investor would have made a stupendous capital gain from holding them. When they were first sold publicly in May 2012, the initial share price was around $18; it rose to more than $50 by early 2013 and was over $160 in the past week or so.

VALUING PEOPLE

Facebook had less than 500m monthly active users of its system in 2010; by mid-2017 it had hit two billion users. Even if one allows for duplicate/fake profiles and for company accounts, that is almost a quarter of the world's population and the number is still growing rapidly. Those figures do not include many users of other Facebook-purchased companies, WhatsApp and Instagram, although there will be some overlap. While the popularity of social media websites can be short-lived, especially among young people, there is no sign yet that this is happening to Facebook.

Strong customer growth and potential market domination have been features of several big, US-based, tech-related companies. Since the 2007-08 financial crisis, low interest rates have helped boost all equity prices, because low yields on government bonds and low interest rates from bank deposits look less attractive to investors by comparison. But these companies' valuations have also jumped more than the market average. The returns from the equities of established blue-chip companies – from their dividends and share price growth – cannot compete with the prospect of buying into a relatively new global market winner. That applies even for one that pays no dividend at all, as has also been true for Amazon.

Facebook has a similar value on the stock market to Amazon. Amazon is favoured for its potential to be *the market* in which goods and services are bought and sold, setting the price and taking a cut from suppliers – although it also has a key revenue source from its web services operation. Facebook, like Amazon, has to expand its clientele, and this is an even bigger imperative since almost all its revenue comes from selling advertising based upon this audience, one investigated and filtered by its algorithms. Hence Zuckerberg's focus on how everyone should 'connect' via Facebook, which is Facebook's attempt to maximise market coverage.

BUSINESS GROWTH AND WHATSAPP

Facebook's business growth shows the success of the company's strategy so far. Revenue jumped from $7.9bn in 2013 to $27.6bn in 2016. Net income after various costs and taxes grew more than threefold, from $1.5bn to $10.2bn over the same period. The background to this growth reveals some interesting points.

As one might expect, Facebook has invested a lot in research and development, committing more than 20% of its total revenues to this, amounting to nearly $6bn in 2016. Like other large corporations, Facebook has also tried to secure its market position through *takeovers* of companies that could complement its business, or ones that might in future be troublesome competitors in areas that it needs for further growth. Since 2005, Facebook has taken control of more than 60 companies in 10 countries – including India, Israel, Canada, the UK and Ireland, although most were from the US. These company acquisitions cost anything from a few hundred thousand to many billions of dollars.

Facebook's biggest acquisition by far was in October 2014, of WhatsApp, the smartphone messaging, voicecall and video service. This underlined Facebook's aim to get into this rapidly growing form of social connection – and of potential advertising revenue.

There have been conflicting media reports of the total price paid for WhatsApp, but it spent 'only' $4.6bn in cash. A much larger amount was also paid for the takeover in terms of Facebook shares, probably worth close to $15bn, giving a total of around $19-20bn. This shows how a key 'social media' company was well versed in using the financial system to establish its market power. That might surprise those who are critical of capitalist financiers, but who pay little attention to how the capitalist system actually works.

The WhatsApp acquisition was striking in another way. Facebook's extravagant price for WhatsApp was despite that company having made *losses* in previous years. At the end of 2014, the 'acquired users' of the WhatsApp system were valued at $2bn, 'trade names' were valued at close to $450m and 'acquired technology' was nearly $300m, but there were tax liabilities of around $900m that made the net assets acquired equal a mere $1.9bn. The remaining $15bn or so that Facebook paid was accounted for as 'Goodwill'.

Goodwill is a feature of company accounts that reflects the value of something that cannot be pinned down in terms of the business assets acquired. It is defined not as a physical asset, eg buildings and equipment, or even technology and existing customer business. It boils down instead to the 'business reputation' or 'brand value' of the company, and basically to its ability to generate revenues as a trusted enterprise. More precisely, it represents the capitalist market's valuation of a company's market presence and potential power, one that is especially highly valued as a takeover target by a budding monopolist with access to funds, like Facebook! The term Goodwill sounds like a transient favourable opinion; it reflects the monetary assessment of contemporary imperialist markets.

STAYING ON TOP OF THE SUGAR MOUNTAIN

Business books have long discussed how managers might control a company although they do not own it, or perhaps have only a small stake in its equity. Marx raised this point in *Capital* and it was popularised in James Burnham's 1941 book, *The Managerial Revolution*. Mark Zuckerberg offers an interesting take on this phenomenon.

Zuckerberg has managed to overcome the usual capitalist norms, where the money invested in a company's shares determines how much power the owner has in company decisions. Such capitalist rules still mean that a small group of larger shareholders can determine the outcome if they can get more than 50% or more of the total. This is not difficult when there is often a very large group of very small shareholders who have negligible voting power. But Zuckerberg has gone much further, as shown by Facebook's issuance of different kinds of shares with very different votes, something also done by other capitalists in the technology sector and elsewhere. [5]

Zuckerberg owns mainly Class B shares, with 10 votes each. The bulk of Facebook's marketed shares, the ones listed for trading on Nasdaq, are Class A shares. These might sound better, since everyone prefers A to B. However, the A shares have just one vote each. The outcome is that Zuckerberg controls 60% of the voting power of Facebook shares although he owns 'only' 28% of the company. Facebook's 2016 annual report is at least honest enough to spell out that he is

"able to exercise voting rights with respect to a majority of the voting power of our outstanding capital stock and therefore has the ability to control the outcome of matters submitted to our stockholders for approval, including the election of directors and any merger, consolidation, or sale of all or substantially all of our assets."

So, the owner with 28% of the shares has complete control of all company decisions! If this were not enough of a challenge to the capitalist market's supposed ideology of equal status before money, Facebook/Zuckerberg managed to top this in 2016. Helped by Zuckerberg's own voting power, Facebook took the decision to issue a new class of shares with *no voting rights* at all. These were Class C shares, ones that, this time, should give investors a clue that they will now be sitting in the bad seats.

Zuckerberg's plan is to issue these new Class C shares in exchange for Class A and B ones, including ones that he holds. This would allow him slowly to sell his shares and thus, piece by small piece, to donate funds to his Chan-Zuckerberg charity, so chipping away at his $100bn-plus mountain of wealth, but still retaining control of decisions at Facebook. The latter charity is his family's philanthropic initiative; based upon him having more money than any sane person could possibly ever spend.

Zuckerberg's charity scheme is one of many examples where a few of the ultra-rich 'give something back', from John D Rockefeller, to Howard Hughes, to Bill Gates, George Soros and Warren Buffett. The donations go to what the plutocrat happens to like, not according to what society needs.

ADVERTS, JUST FOR YOU!

The personal details of its two billion users are the raw material from which Facebook creates an attractive platform for advertisers. Filtered further by Facebook tracking 'likes' and clicks into other Internet sites, it can offer a defined audience far better than news media and TV companies, so it can claim to focus more than others on the relevant age group and inclinations of consumers.

The traditional media has not managed to keep up, even when it has gone online, as shown in the problems newspapers have had deciding whether to set up paywalls for their content, or whether to try and maximise viewers and boost advertising revenues by giving free access to that content. Even though Facebook's 'click through rate' from the advertisements it shows is very low, with younger people better at ad blocking, so far that has not been a problem for the growth of its advertising revenues.

Nevertheless, Facebook does worry about *future* revenues. Has the core site now reached 'saturation point' for advertising? Will new ventures into virtual reality products, via its acquisition of Oculus for $2bn in 2014, help out? Can the WhatsApp acquisition generate enough money when it starts charging users?

CONCLUSIONS

Facebook's core area of business has been the US and Canada, from which roughly half its global revenues are generated. The availability of wealthy US investors to fund Facebook's early investments and growth has also been critical for the company.[6] As in the case of Amazon, this highlights how the global success of a commercial enterprise is boosted by it starting up from a big, rich country, with the US having the pre-eminent position.

Facebook's growth has absorbed some of the advertising revenues of other businesses and helped undermine them. But it is a better example of capitalism's conflict between the forces and relations of production. The forces – the development of an easy global transmission for all kinds of data, ideas and information – are channelled by a system that accumulates the personal and social information of billions of people for private profit. Facebook is basically an advertising platform, and advertising is intimately related to the rise of mass production and the generation of monopolies, even in areas of new technology.

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